# SINGAPORE REPORTS

## Korea Industry Co Ltd v Andoll Ltd

COURT OF APPEAL (SINGAPORE) - CIVIL APPEAL NO 59 OF 1986
CHAN SEK KEONG AND CHUA JJ, GRIMBERG JC
28 SEPTEMBER 1989

*Banking - Letter of credit - Injunction to restrain payment under letter of credit - Fraud exception - Evidentiary requirements*

The respondents had contracted to purchase, and the appellants to sell, a quantity of what was described in the contract as 'low speed diesel oil (gas oil)' of a stipulated flash point and sulphur content, payment to be made by a letter of credit in favour of the appellants which was duly opened. The respondents, in pursuance of the contract, arranged for the bank to open a letter of credit for the purchase price in favour of the appellants. However, when the cargo arrived in Bangkok, the respondents concluded that what the appellants sought to deliver was not 'low speed diesel oil' as called for in the contract. They rejected the cargo and applied for, and obtained, an ex parte interim injunction restraining the bank from making payment under the letter of credit.

In their statement of claim, the respondents did not allege any fraud. The respondents applied by motion to continue the injunction; the appellants by summons, to discharge it. At the hearing of the respondents' motion to continue the injunction (which was tried together with the appellants' summons to discharge it), the respondents asserted that there was fraud on the part of the appellants. The learned judge concluded that the evidence before him was such as to bring the case within the exceptional class in which an issuing bank may be restrained from making payment under a letter of credit on the grounds of fraud. The injunction was allowed to continue and from that decision, the appellants appealed.

**Held**, allowing the appeal and discharging the injunction:

(1) In the ordinary course of events, the court will not restrain the payment of funds due under an irrevocable letter of credit. It will not do so simply because a dispute exists between the buyer and seller with regard to the contract underlying the letter of credit.

(2) The court may, exceptionally, enjoin payment under an irrevocable letter of credit where there has been or is likely to be a fraudulent demand under the credit, and the bank is aware that the demand, made or to be made, is fraudulent.

(3) The American case of *Sztejn*[3] cited by the House of Lords in the *United City Merchants* case[2] fell fairly and squarely within the 'fraud exception' now recognized by the English courts. The fraud exception under *Sztejn*[3] did not require the court to embark upon an investigation as to whether or not the goods tendered by the appellants were worthless. The question is whether the seller, for the purpose of drawing on the credit, fraudulently presented documents that contain, expressly or by implication, material representations of fact that to his knowledge are untrue?

(4) Judges who are asked, ex parte, to issue an injunction restraining payment by a bank under an irrevocable letter of credit or performance bond or guarantee, should ask whether there is any challenge to the validity of the letter, bond or guarantee itself. If there is not, the bank should be free to honour its contractual obligation, although restrictions may be imposed upon the freedom of the beneficiary to deal with the money after he has received it.

(5) This appeal turned on the issue as to whether there was any evidence which brought the case within the 'fraud exception'. In the court's view there was not. Where fraud is alleged at an interlocutory stage, there must be clear evidence to support the allegation, with strong corroborative evidence in the form of contemporary documents; the buyer must also be given an opportunity to answer the allegations and to have failed to answer adequately.

**Cases referred to**

1 *Hamzeh Malas & Sons* v *British Imex Industries* [1958] 2 QB 127 (folld)
2 *United City Merchants (Investments) Ltd & Ors* v *Royal Bank of Canada & Ors* [1982] 2 Lloyd's Rep 1 (folld)
3 *Sztejn* v *J Henry Schroder Banking Corp* (1941) 31 NYS 2d 631 (refd)
4 *Bolivinter Oil SA* v *Chase Manhattan Bank* [1984] 1 Lloyd's Rep 251 (folld)
5 *United Trading Corp SA* v *Allied Arab Bank* [1985] 2 Lloyd's Rep 554 (folld)

**Appeal from**: Suit No 24198 of 1986 (High Court, Singapore).

*Kenneth Tan* for the appellants.
*G Raman* for the respondents.

*Cur Adv Vult*

**Grimberg JC** (delivering the judgment of the court): This was an appeal from an order of a judge by which he continued an injunction granted to the respondents, the plaintiffs in the action, restraining the second defendant bank ('the bank') from making payment under an irrevocable letter of credit issued by the bank in favour of the appellants at the request of the respondents. [See [1987] 2 MLJ 425.] The bank was not a party to the appeal, having throughout taken a neutral stand in the dispute between the appellants and the respondents.

The facts were that the respondents had contracted to purchase, and the appellants to sell, a quantity of what was described in the contract as 'low speed diesel oil (gas oil)' of a stipulated flash point and sulphur content, for delivery in Bangkok, payment to be made by a letter of credit in favour of the appellants.

The respondents, in pursuance of the contract, arranged for the bank to open a letter of credit for the purchase price in favour of the appellants. However, when the cargo arrived in Bangkok, the respondents concluded that what the appellants sought to deliver was not 'low speed diesel oil' as called for in the contract. They rejected the cargo and applied for and obtained an ex parte interim injunction restraining the bank from making payment under the letter of credit.

In their statement of claim, the respondents alleged that the appellants had delivered 'fuel oil or a blend of fuel oil and crude oil instead of low speed diesel oil as agreed',

resulting in the respondents' buyers refusing to take delivery because the commodity was 'entirely different from what was contracted for'. No fraud was alleged.

In his affidavit affirmed in support of the application for the interim injunction, Loy Chee Yan, of the respondents, claimed that the cargo which the appellants sought to deliver was 'very different from the commodity that was contracted for', and supported that assertion by exhibiting two inspection reports in which the cargo was described as 'fuel oil' and 'light fuel oil' respectively, with a flash point substantially lower than that called for under the contract, and a sulphur content which was also off specification. Loy Chee Yan went on to state:

> There is therefore being [sic] gross misrepresentation bordering on fraud and the first defendants ('the appellants') are therefore not entitled to be paid the price for the said cargo.

That was as close as the respondents got to alleging fraud at the ex parte stage, and it was on the basis of this evidence that they were granted the interim injunction restraining the bank from effecting payment under the letter of credit.

The respondents applied by motion to continue the injunction; the appellants by summons, to discharge it. The appellants' application was put on two grounds; first, that the respondents had no cause of action against the bank; and secondly, that notwithstanding any dispute between a buyer and seller in relation to an underlying contract, the seller is entitled to payment under an irrevocable letter of credit opened by the purchaser pursuant to the contract.

At the hearing of the respondents' motion to continue the injunction (which was tried together with the appellants' summons to discharge it), counsel for the respondents asserted that there was fraud on the part of the appellants. He referred to a related action, Suit No 2523 of 1986, in which the respondents were the defendants. The plaintiff in that suit ('Wanda Trading') was the party to whom the respondents had on-sold the cargo purchased by them from the appellants. Wanda Trading had obtained an injunction against Banque Nationale de Paris restraining that bank from making payment under a letter of credit opened in favour of the respondents, on the grounds of the respondents' fraud.

In the course of argument before the learned judge, counsel for the respondents apparently produced for visual inspection by the learned judge, a sample of the oil contracted for by Wanda Trading, and a sample of the cargo actually tendered at Bangkok by the appellants. The learned judge said:

> In the course of arguments counsel for the plaintiffs, Mr G Raman, pointedly claimed that a fraud had been perpetrated against the plaintiffs by the first defendants who had presented documents purporting to evidence the shipment of diesel when in truth and in fact sludge or light fuel oil with flash point from 97 to 57 degrees were shipped and tendered in Bangkok. At this stage I did not have to find nor would I be entitled to find that the first defendants had perpetrated a fraud against the plaintiffs. I was, however, satisfied from comparing the contract sample and the sample taken of the goods found on board the vessel that the latter was clearly murky and black; that from the inspection by the end buyers in Bangkok and from the results of the independent surveys carried out, there were substantial evidence that sludge was in truth and in fact tendered as diesel oil which, if proved, would constitute a fraud on the plaintiffs. I was satisfied that sufficiently grave cause had been shown by the plaintiffs why Banque Paribas, who were duly apprised of the evidence adduced in these interlocutory proceedings, should be restrained from accepting the documents tendered and since fraud would vitiate all, I felt that I should follow what Shientag J said in the famous American case of *Sztejn* v *J Henry Schroder Banking Corp* (1941) 31 NYS 2d 631 as follows: 'In such a situation, where the seller's fraud has been called to the bank's attention before the drafts and documents have been presented for payment, the principle of the independence of the bank's obligation under the letter of credit should not be extended to protect the unscrupulous seller.'

In deciding to continue the injunction against the bank, the learned judge concluded that the evidence before him was such as to bring the case within the exceptional class in which an issuing bank may be restrained from making payment under a letter of credit on the grounds of fraud.

In argument before us on the appeal, there was no real contest as to what the law on the subject is. It may, we think, be stated in this way. First, in the ordinary course of events, the court will not restrain the payment of funds due under an irrevocable letter of credit. It will not do so simply because a dispute exists between the buyer and seller with regard to the contract underlying the letter of credit. In *Hamzeh Malas & Sons* v *British Imex Industries*,[1] Jenkins LJ (at pp 129-130) said:

> We have been referred to a number of authorities, and it seems to be plain enough that the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods, which imposes upon the banker an absolute obligation to pay, irrespective of any dispute there may be between the parties as to whether the goods are up to contract or not. An elaborate commercial system has been built up on the footing that bankers' confirmed credits are of that character, and, in my judgment, it would be wrong for this court in the present case to interfere with that established practice.
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> There is this to be remembered, too. A vendor of goods selling against a confirmed letter of credit is selling under the assurance that nothing will prevent him from receiving the price. That is of no mean advantage when goods manufactured in one country are being sold in another. It is, furthermore, to be observed that vendors are often reselling goods bought from third parties. When they are doing that, and when they are being paid by a confirmed letter of credit, their practice is - and I think it was followed by the defendants in this case - to finance the payments necessary to be made to their suppliers against the letter of credit. That system of financing these operations, as I see it, would break down completely if

a dispute as between the vendor and the purchaser was to have the effect of 'freezing', if I may use that expression, the sum in respect of which the letter of credit was opened.

I agree with Mr Gardiner that this is not a case where it can be said that the court has no jurisdiction to interfere. The court's jurisdiction to grant injunction is wide, but, in my judgment, this is not a case in which the court ought, in the exercise of its discretion, to grant an injunction. Accordingly, I think this application should be refused.

So also, in *United City Merchants (Investments) Ltd & Ors* v *Royal Bank of Canada & Ors*[2] at p 6, Lord Diplock said:

Again, it is trite law that in contract (4), with which alone the instant appeal is directly concerned, the parties to it, the seller and the confirming bank, 'deal in documents and not in goods', as art 8 of the Uniform Customs puts it. If, on their face, the documents presented to the confirming bank by the seller conform with the requirements of the credit as notified to him by the confirming bank, that bank is under a contractual obligation to the seller to honour the credit, notwithstanding that the bank has knowledge that the seller at the time of presentation of the conforming documents is alleged by the buyer to have, and in fact has already, committed a breach of his contract with the buyer for the sale of the goods to which the documents appear on their face to relate, that would have entitled the buyer to treat the contract of sale as rescinded and to reject the goods and refuse to pay the seller the purchase price. The whole commercial purpose for which the system of confirmed irrevocable documentary credits has been developed in international trade is to give to the seller an assured right to be paid before he parts with control of the goods; that does not permit of any dispute with the buyer as to the performance of the contract of sale being used as a ground for non-payment or reduction or deferment of payment.

Second, the court may, exceptionally, enjoin payment under an irrevocable letter of credit where there has been or is likely to be a fraudulent demand under the credit, and the bank is aware that the demand, made or to be made, is fraudulent. The exception was referred to by Lord Diplock in the *United City Merchants* case,[2] as follows:

To this general statement of principle as to the contractual obligations of the confirming bank to the seller, there is one established exception: that is, where the seller, for the purpose of drawing on the credit, fraudulently presents to the confirming bank documents that contain, expressly or by implication, material representations of fact that to his knowledge are untrue. Although there does not appear among the English authorities any case in which this exception has been applied, it is well established in the American cases of which the leading or 'landmark' case is *Sztejn* v *J Henry Schroder Banking Corp* (1941) 31 NYS 2d 631. This judgment of the New York Court of Appeals was referred to with approval by the English Court of Appeal in *Edward Owen Engineering Ltd* v *Barclays Bank International Ltd* [1978] 1 Lloyd's Rep 166; [1978] QB 159, though this was actually a case about a performance bond under which a bank assumes obligations to a buyer analogous to those assumed by a confirming bank to the seller under a documentary credit. The exception for fraud on the part of the beneficiary seeking to avail himself of the credit is a clear application of the maxim ex turpi causa non oritur actio or, if plain English is to be preferred, 'fraud unravels all'. The courts will not allow their process to be used by a dishonest person to carry out a fraud.

We do not think that by virtue of his reference to the American case of *Sztejn*,[3] Lord Diplock intended to widen the ambit of the 'fraud exception'. *Sztejn*[3] was a case in which the seller beneficiary contracted to supply a quantity of bristles. Instead, the seller consigned a quantity of cowhair and other worthless material and rubbish. The case proceeded upon the assumption that the seller had engaged in a scheme to defraud the buyer, and that the documents accompanying the drafts issued under an irrevocable letter of credit were fraudulent in that they did not represent actual merchandise but covered cases filled with the worthless material.

It was on that basis that the court in *Sztejn*[3] restrained payment under the drafts. The case fell fairly and squarely within the 'fraud exception' now recognized by the English courts. *Sztejn*[3] did not, in our judgment, require us to embark upon an investigation as to whether or not the goods tendered by the appellants were worthless, because it is perfectly possible for fraud to occur when goods having a value are shipped. The ultimate question remains, as Lord Diplock put it: 'Did the seller, for the purpose of drawing on the credit, fraudulently present ... documents that contain, expressly or by implication, material representations of fact that to his knowledge are untrue?'

More recently, in *Bolivinter Oil SA* v *Chase Manhattan Bank*,[4] Sir John Donaldson MR said at p 257:

Judges who are asked, often at short notice and ex parte, to issue an injunction restraining payment by a bank under an irrevocable letter of credit or performance bond or guarantee should ask whether there is any challenge to the validity of the letter, bond or guarantee itself. If there is not or if the challenge is not substantial, prima facie no injunction should be granted and the bank should be left free to honour its contractual obligation, although restrictions may well be imposed upon the freedom of the beneficiary to deal with the money after he has received it. The wholly exceptional case where an injunction may be granted is where it is proved that the bank knows that any demand for payment already made or which may thereafter be made will clearly be fraudulent. But the evidence must be clear, both as to the fact of fraud and as to the bank's knowledge. It would certainly not normally be sufficient that this rests upon the uncorroborated statement of the customer, for irreparable damage can be done to a bank's credit in the relatively brief time which must elapse between the granting of such an injunction and an application by the bank to have it discharged.

There being no dispute before us as to the state of the law, and the argument that the respondents had no cause of action against the bank not having been, in our view correctly, seriously pursued, this appeal turned on the issue as to whether there was any evidence which brought the case within the 'fraud exception'.

In our view there was not. The respondents launched their action without alleging fraud. They put their claim on the footing, in effect, that the appellants had, in breach

of contract, sought to deliver merchandise 'entirely different from what was contracted for'. In their ex parte application for the interim injunction, the respondents stopped short of alleging fraud. It was only in an affidavit of the respondents' Kwok Wye Kock, filed in support of the motion to continue the injunction, that an unequivocal assertion of fraud on the part of the plaintiffs was made, in these terms:

> On the basis of these discrepancies (between the specifications called for in the contract and those of the cargo delivered) and on the difference in the grade of oil it became very clear that there has been a fraud perpetrated by 'the appellants' in that they had delivered a cargo of oil which was entirely different from what was contracted for.

That assertion on the part of Kwok was a non-sequitur - it did not follow from the fact that the cargo was off-specification in two respects, resulting (if it did) in a different grade of oil being tendered, that the appellants had perpetrated a fraud. Where fraud is alleged at an interlocutory stage in an action, there must be clear evidence to support the allegation. In *United Trading Corp SA* v *Allied Arab Bank*,[5] Ackner LJ said at p 561:

> The evidence of fraud must be clear, both as to the fact of fraud and as to the bank's knowledge. The mere assertion or allegation of fraud would not be sufficient (see *Bolivinter Oil SA* v *Chase Manhattan Bank NA* [1984] 1 Lloyd's Rep 251 per Sir John Donaldson MR at p 257). We would expect the court to require strong corroborative evidence of the allegation, usually in the form of contemporary documents, particularly those emanating from the buyer. In general, for the evidence of fraud to be clear, we would also expect the buyer to have been given an opportunity to answer the allegation and to have failed to provide any, or any adequate answer in circumstances where one could properly be expected. If the court considers that on the material before it the only realistic inference to draw is that of fraud, then the seller would have made out a sufficient case of fraud.

In our view the respondent's evidence of fraud did not begin to approach the required standard.

The learned judge erred in concluding that there was substantial evidence that 'sludge was in truth and in fact tendered as diesel oil which, if proved, would constitute a fraud against the plaintiffs'. Putting the appellant's position at its lowest, they tendered light fuel oil instead of diesel oil. There was no evidence that light fuel oil is sludge, or that it is of no commercial value, even if that were relevant.

The learned judge appears to have been influenced by two factors which ought not, in our judgment, to have affected his mind. The first was his own visual inspection of samples which related to Wanda Trading's claim against the respondents, and not the case before him; and the second was the fact that Wanda Trading had obtained an injunction in their action against the respondents and Banque Nationale de Paris, restraining the latter from making payment to the respondents under a letter of credit opened by Wanda Trading, in payment for the cargo purchased by the respondents from the appellants, and on-sold by the respondents to Wanda Trading. We were informed by counsel for the respondents that in those proceedings, the respondents had, in their wisdom, conceded that fraud had been perpetrated against Wanda Trading.

One further factor rendered the continuation of the injunction wrong, in our judgment, and that was the absence of any evidence that the appellants were party to the fraud, even had fraud existed. Indeed the evidence tended the other way. The respondents were aware that the appellants had purchased the cargo from a North Korean end-supplier. The cargo was inspected before shipment and apparently found to be on-specification; it was shipped by the end-supplier directly to the respondents in Bangkok; and the appellants were obliged to pay the end supplier for the cargo, albeit under protest.

In the result, we allowed the appeal with costs, and discharged the injunction which, in our view, ought not to have been issued. The respondents' remedy, if any, clearly lay in damages.

*Appeal allowed.*

Solicitors: *Rajah & Tann; G Raman & Partners.*

Reported by *Terence Tan Bian Chye*